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DISPUTE RESOLUTION ALERT

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INTERNATIONAL ARBITRATION: *MISCHIEF* IN THE *FIERY* PACIFIC

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Mischief Reef, Fiery Cross Reef, Second Thomas Shoal, Subi Reef, Gaven Reef and McKennan Reef are but a few of the inconspicuous and (previously) uninhabitable natural reefs located in the South China Sea, currently at the centre of an international "tug-of-war", the result of which may very well change the political landscape of the region.

The South China Sea is one of the world's most strategically vital maritime regions conveying more than US$5 trillion in trade, constituting one third of all global maritime commerce. It is therefore understandable why no fewer than five governments have laid claim to portions of this sea which claims, as has recently been demonstrated, often overlap. The nations tussling for dominance are China, Malaysia, the Philippines, Vietnam and Taiwan.

China can be described as the catalyst for the current disagreement, as it is seeking to control almost the entire South China Sea. China's claim is based upon a highly contentious U-shaped "nine–dash line" appearing on certain historical Chinese maps, dating back to 1947. The origin of and the reason for the "nine–dash line" are anything but clear.

The current dispute has arisen out of the principles of the United Nations Convention on the Law of the Sea (UNCLOS). UNCLOS is binding upon, at least, China, Malaysia and the Philippines. In accordance with the provisions of UNCLOS, only a natural formed island that can support human or economic life can justify a claim to an "exclusive economic zone" (EEZ). Such an EEZ can extend up to 200 nautical miles off the coast of such an island, making an EEZ in the South China Sea a prized asset.

The large majority of "islands" constituting the Spratly Islands, of which the contentious reefs form part, are in fact not islands at all. Insofar as these qualify as either "low-tide elevations" or "rocks" under UNCLOS, no EEZ rights follow. A low-tide elevation is simply a piece of land that is exposed at low-tide but submerged by the sea at high-tide. The Philippines have argued that Mischief Reef, Second Thomas Shoal, Subi Reef, Gaven Reef and McKennan Reef are such "low-tide elevations". They similarly argue that Scarborough Shoal, Johnson Reef, Cuarteron Reef and Fiery Cross Reef are to be classified as rocks. The definition of "rocks" under UNCLOS is an island "which cannot sustain human habitation or economic life of their own". Under UNCLOS, rocks only entitle a party to a 12 nautical mile territorial sea around it (as opposed to the 200 nautical mile EEZ surrounding islands).

Over the last few years, China has asserted its influence and control over the region and has implemented rather drastic land reclamation efforts in relation to certain of these "islands". For example, in 2014 the Fiery Cross Reef (over which four governments currently claim control), comprised one small weather station.

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Now, in 2016, China has transformed it into a habitable man-made "island" containing a running track, basketball courts and most importantly, a runway capable of entertaining military jets. China has made its intentions for the region clear and, with its resources heavily overshadowing those of nations competing for the region, it has no reason to back down.

On 22 January 2013, the Philippines served a notification and statement of claim on China, through the Permanent Court of Arbitration (seated in The Hague), "with respect to the dispute with China over the maritime jurisdiction of the Philippines in the West Philippine Sea". The arbitration was initiated in accordance with the provisions of s2 of Part XV of UNCLOS. China responded by means of a diplomatic note and refused to engage in the arbitration proceedings. China firstly disputed the tribunal's jurisdiction to entertain the dispute and secondly disputed the merits of the claims made by the Philippines. The Permanent Court of Arbitration has already ruled that it has jurisdiction to entertain the dispute and is expected to hand down its ruling on the merits of the dispute imminently.

But what happens if the tribunal rules in favour of the Philippines? China has already indicated that it will not acknowledge or abide by any ruling of the arbitral tribunal. China has argued that the issues in dispute relate to the "sovereignty of nations" and as such fall outside of the jurisdiction of any tribunal constituted in accordance with UNCLOS.

None of the other parties involved in the current dispute possess the necessary resources to challenge the might of China. One nation with the power to challenge China's tactics in the region is the US. In 2010, Hillary Clinton, the then US Secretary of State stated that the US "has a national interest in freedom of navigation... and respect for international law in the South China Sea". In the words of Rear Admiral Marcus Hitchcock, current commander of the *Stennis* strike group, the US is "very invested in the economic development and building of commerce in the region". The USS John C. Stennis, a Nimitz-class nuclear-powered aircraft carrier, duly escorted by a trio of guided-missile destroyers and an Aegis Cruiser, together with more than 3000 military personnel, have been deployed by the US to the region.

Colonel Liu Mingfu, a Chinese military commentator has expressed a view that "by using the South China Sea to contain China, America has turned a regional issue into a global issue...too many countries are now involved, and that's dangerous".

On 24 May 2016 (with reference to the South China Sea), President Obama stated that "nations are sovereign, and no matter how large or small a nation may be, its territory should be respected...big nations should not bully smaller ones". The US have also expressed an interest in the outcome of the arbitration proceedings and previously requested permission to send an observer to the proceedings. The request was, however, declined and as

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a result, the US did not play any part in the arbitration proceeding. The request was declined for a simple reason: the US had not ratified and was not a party to UNCLOS. Awkward.

The US may very well find itself in a rather uncomfortable position by trying to assist with the enforcement of an arbitral award issued against China arising out of an international convention it took a deliberate decision not to be a party of. Matters will become even more difficult if China follows through with its threat to leave UNCLOS if the award is granted in favour of the Philippines. A "bully brawl" may very well be brewing in the South China Sea...

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BUSINESS RESCUE AND INSOLVENCY:
WHAT ARE YOUR RIGHTS SHOULD YOU RECEIVE A SUBPOENA TO ATTEND AN INSOLVENCY ENQUIRY?

The general rule is that a subpoenaed witness is compelled to attend, subject to procedural requirements being met, and the evidence sought being relevant to the insolvent company or entity.

In *Roering & Another NNO v Mahlangu* (581/2015) [2016] ZASCA 79 heard recently, the Supreme Court of Appeal (SCA) considered the circumstances that might justify a witness under subpoena applying for enquiry proceedings to be set aside or for the witness to be excused from attending those proceedings.

The SCA rejected the witness' argument which in essence was that whenever civil litigation may involve an insolvent entity, a potential witness in that litigation could never be subpoenaed to appear at an insolvency enquiry.

The general rule is that a subpoenaed witness is compelled to attend, subject to procedural requirements being met, and the evidence sought being relevant to the insolvent company or entity.

In the *Roering* matter a subpoena was issued to a witness to attend an insolvency enquiry convened in terms of s417, read with s418 of the Companies Act, No 61 of 1973 (Act). The liquidators were of the view that the witness would be able to provide important information about a possible claim against another entity by the company in liquidation.

The witness contended that the enquiry was an abuse of process as she was a potential witness in current or future litigation proceedings and her examination may result in the liquidators possibly acquiring unfair insight into what the witness might say when giving evidence at the later trial. (This is commonly referred to as improper or unfair litigation advantage.)

The subpoena was set aside by the High Court but that decision was overturned by the SCA. The SCA rejected the witness' argument which in essence was that whenever civil litigation may involve an insolvent entity, a potential witness in that litigation could never be subpoenaed to appear at an insolvency enquiry in respect of that insolvent entity.

Reference was made to the well-known *Bernstein and others v Bester and others* NNO [1996] ZACC 2; 1996 (2) SA 751 (CC) case where the Constitutional Court held that the liquidator is entitled to obtain information - not only to ascertain whether the company has a cause of action but also in order to assess whether the case is sufficiently strong to spend the creditors' money in pursuing it, and conversely to ascertain whether there is an adequate defence to a claim against the company. The SCA held that the process involved in making such an assessment could not, in the normal course, constitute an abuse. However, in certain circumstances enquiry proceedings could indeed constitute an abuse.

Courts have the power, and indeed the obligation to restrain the use of power of an enquiry where it would "constitute an abuse". It is, however, difficult to legislate exactly what constitutes an abuse.

Courts will generally not permit liquidators or commissioners to abuse its process by using an examination solely for the purposes of obtaining "a forensic advantage". What constitutes an improper forensic advantage will depend on the facts of each case.

An examination may be an abuse where:

- the advantage is solely for the benefit of a third party, such as a creditor and not for the liquidators and the general body of creditors;
- the subpoena is directed at obtaining pre-trial discovery when a discovery order had been refused in proceedings that were already ongoing;
- an enquiry is engineered shortly before a trial in which the liquidators are the plaintiff - in order to obtain ammunition to attack the defendant in the trial; and

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The fundamental issue in determining where an abuse had occurred was "whether the enquiry was being used for a purpose not contemplated by the Act".

- evidential material is available to the liquidators from alternative sources or can be obtained by simple alternative means, without resort to an enquiry, this may show that the liquidators have ulterior motives. Ulterior motive and harassment are also well recognised grounds to challenge enquiry proceedings generally.

The SCA concluded its findings by stating that the fundamental issue in determining where an abuse had occurred was "whether the enquiry was being used for a purpose not contemplated by the Act".

Put differently in the case of *Excel Finance Corporation Ltd John Frederick Worthley v Richard Anthony Fountayne England* [1994] FCA 1251 the use of the process or abuse of it will "depend on purpose rather than result".

In the *Roering* matter the appeal was upheld with costs and the application to set aside the insolvency enquiry proceedings, as far as the witness was concerned, was reversed.

There are three other fairly common instances, besides the one discussed in the *Roering* case, where a recipient of a subpoena may object to attending or testifying. These are where:

- the evidence presented may be incriminating in nature - no person interrogated is entitled to refuse to answer a question on the ground that the answer may incriminate them. However if they do refuse, they are obliged to answer the question provided that the Master or Officer presiding has consulted with the Director of Public Prosecutions in that area. This obligation is subject to the rider that any incriminating answer or information obtained and derived from the interrogation is not admissible as evidence in subsequent criminal proceedings subject to certain limited exceptions. It is, however, admissible in subsequent civil proceedings;
- the notice is unreasonable (it is generally accepted that three weeks' notice is sufficient) or the reasonable attendance costs and witness fees have not been tendered; and
- the person's evidence cannot be relevant with reference to whether that person is capable of giving information concerning "the trade, dealings, affairs and property of the company in liquidation", or not.

A person subpoenaed to appear at an insolvency enquiry is always entitled to legal representation at the enquiry. If you receive a subpoena or summons to attend any form of insolvency enquiry you should immediately approach an attorney to obtain advice as to your legal rights. It may be that you are not obliged to attend and it may be that you will prejudice yourself if you do not attend without being represented.

Grant Ford and Michail le Roux

CLICK HERE to find out more about our Business Rescue and Insolvency team

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BBBEE STATUS: LEVEL THREE CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 3 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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